

Advanced Not-For-Profit Accounting and Financial Reporting Issues

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Accounting for Contributions

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First Some of the Basics

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- Contribution – Unconditional transfer of cash or other assets to an entity or a settlement or cancelation of its liabilities in a voluntary non-reciprocal transfer by another entity acting other than as an owner.

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- Donor-Imposed Restriction – Limits the use of contributed [net] assets; it specifies a use that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its articles of incorporation or bylaws...

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- Restrictions may be stipulated explicitly by the donor or result implicitly from the circumstances surrounding receipt of the contribution – for example, a campaign’s stated objective or content of other solicitation material.

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- The following is an actual statement made by a charitable organization designed to address possible misunderstanding with respect to donor intent:
 - Your gift will be used exclusively for the exempt purposes of XX International. The ministry features specific outreaches as examples of the programs it supports and conducts. Gifts are considered to be without restriction as to use unless explicitly stipulated by the donor.

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- Donors can impose restrictions on otherwise unrestricted net assets, as well as on their own contributions.

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- Contributions with donor-imposed restrictions shall be reported as restricted support; however...contributions whose restrictions are met in the same reporting period [as received] may be reported as unrestricted support...

Must apply consistently and disclose policy

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- Receipts of unconditional promises to give with payments due in future periods shall be reported as restricted support unless explicit donor stipulations or circumstances surrounding the receipt of a promise make clear that the donor intended it to be used to support activities of the current period.

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- Determining whether a promise is conditional or unconditional can be difficult. A promise containing stipulations that are not clearly unconditional should be presumed to be a conditional promise.

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- A temporary restriction expires when the stipulated time has elapsed, when the stipulated purpose has been fulfilled, or both.

Technical Practice Aid 6140.04?

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- If an expense is incurred for a purpose for which both unrestricted and temporarily restricted net assets are available, a donor-imposed restriction is fulfilled...unless the expense is for a purpose directly attributable to another specific external source of revenue.

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- Not-for-profit organizations may receive contributions of long-lived assets (such as property and equipment) or of cash and other assets restricted to the purchase of long-lived assets. An organization may adopt an accounting policy of implying time restrictions on the use of such contributed assets that expire over the assets' expected useful lives. If an organization adopts such a policy, the contributions received should be reported as restricted support that increases temporarily restricted net assets. Depreciation should be recorded over the asset's useful life, and net assets should be reclassified periodically from temporarily restricted to unrestricted as depreciation is recognized.

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- Transfers of assets from governments are
 - A. Exchange transactions or
 - B. Contributions or
 - C. Difficult to determine whether A or B

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- Not-for-profit organizations may receive communications that are intentions to give, rather than promises to give. For example, communications from individuals indicating that the organization has been included in the individual's will as a beneficiary are intentions to give. Such communications are not unconditional promises to give, because individuals retain the ability to modify their will during their lifetimes.

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- Some not-for-profits act as agents, trustees, or intermediaries, helping donors to make a contribution to another entity or individual. In general, if a donor specifies a beneficiary, the recipient organization should not recognize a contribution.

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- Other issues around contributions include
 - Are controls adequate to ensure that all unconditional contributions and promises to give are recognized?
 - When statement of activities delineates operating and non-operating – where are contributions?
 - Dealing with the variability of bequests.
 - Disclosure of concentration (i.e. significant amounts from relatively few donors).
 - Donor advised funds and pledges.



Let's Discuss Some Real Examples

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AMENDMENT TO AGREEMENT OF GIFT

Effective immediately, my Agreement of Gift to Non-Profit A dated x/x/xx is amended as follows:

I acknowledge that my gift to Non-Profit A of a donor restricted endowment fund will be commingled with the organization's investment portfolio (the "Fund") and that a portion of the investment return (interest, dividends, realized and unrealized gains and losses) generated will be utilized to support the activities of the organization in accordance with its mandated spending policy. I also understand and acknowledge that due to market fluctuations, the Fund may experience negative returns with respect to its investments and as a result, a decline in the value of the Fund may cause a similar decline in the value of my individual endowment fund.

I also acknowledge that Non-Profit A intends to invest its assets prudently and, to the extent that negative returns of the Fund may have caused the fair market value of my individual endowment fund to decline below the original historical value of my gift. I agree to allow such losses on the investments of my endowment fund to reduce the original historical value of my gift without any requirement to eliminate such shortfall.

Signature

Date

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Organization X
Pledge Card Language

"I promise to give \$1,000,000 in support of Organization X's Campaign for a Better Tomorrow. The sum will be paid from my estate and I have included Organization X as named beneficiary in my will."

Should this be recognized as revenue?

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Organization X with an August 31, fiscal year end receives a foundation grant with the following language contained in the award letter dated July 1, 2004.

"Our grant for \$200,000 is provided to support the organization's poverty program. The grant period is June 1, 2004 through May 31, 2006. Payments of \$100,000 each will be made on December 1, 2004 and December 1, 2005."

In its fiscal 2004 financials, Organization X records \$200,000 (discount is immaterial) of temporarily restricted revenue and asks advice with respect to the amount that should be released from restriction. The Organization has determined that \$250,000 of poverty program expenses for the year ended August 31, 2004 are "unfunded" (i.e. have not been covered by another restricted funding), including \$150,000 incurred in the last quarter of fiscal 2004. What would you suggest be released?

- A) \$25,000
- B) \$150,000
- C) The portion of the \$150,000 incurred after July 1
- D) Another amount \$_____
- E) The grant represents an exchange transaction and only \$150,000 should be recognized as unrestricted revenue.

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I am writing to modify the payment terms included in my pledge agreement with Organization X dated August 17, 2006, as follows:

Superseded Terms: "2,000,000 per year payable in 2007, 2008, 2009, 2010 and 2011."

Revised Terms: "\$10,000,000 to be paid upon my death from my estate. This pledge shall be binding on my estate, heirs, successors, assigns and personal representatives."

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"I am pleased to inform you that the Foundation has authorized a grant of \$4,500,000 over three years to the Organization for general operating support. The grant will be paid in three installments. In order for us to make payment, we require that you accept the terms of the grant as set forth in the following paragraphs....."

The Foundation's disbursement of payments is contingent upon the Foundation's review of your work in connection with our exempt purposes and its determination that you are in compliance with all terms and conditions of this grant agreement and are carrying out your exempt functions in an efficient and productive way. Funding may be repaid, if at any time the Foundation determines that the purposes of the grant are not being met, or the Foundation determines, in its sole discretion, that the Organization is no longer productive in fields of interests to the Foundation."

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"I want to take this opportunity to confirm my unrestricted pledge of \$1,000,000 to the University in support of the building project. I intend to pay this pledge over five years beginning in 2007.

Should you not proceed with the building project, I reserve the right to suspend payment on the full pledge and to restrict any funds that I have paid into the University for a purpose of my choosing."

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Before a promise to give can be recognized, sufficient verifiable evidence should exist.

What about written acknowledgements?

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Related Party Disclosures

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- Disclosure of Related Party Transactions is inconsistent. What is material?

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16. Related Party Transactions

Members of the University's Board of Trustees and senior management may, from time to time, be associated, either directly or indirectly, with companies doing business with the University. For senior management, the University requires annual disclosure of significant financial interests in, or employment or consulting relationships with, entities doing business with the University. These annual disclosures cover both senior management and their immediate family members when such relationships exist, measures are taken to appropriately manage the actual or perceived conflict in the best interests of the University. The University has a written conflict of interest policy that requires, among other things, that no member of the Board of Trustees can participate in any decision in which he or she (or immediate family member) has a material financial interest. Each trustee is required to certify compliance with the conflict of interest policy on an annual basis and indicate whether the University does business with an entity in which a trustee has a material financial interest. When such relationships exist, measures are taken to mitigate any actual or perceived conflict, including requiring that such transactions be conducted at arm's length, for good and sufficient consideration, based on terms that are fair and reasonable to and for the benefit of the University, and in accordance with applicable conflict of interest laws. No such associations are considered to be significant.

*Excerpted from Stanford University's
2007 Financial Statements*

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Statement of Cash Flows

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Statement of Cash Flows

- Does it receive audit committee attention?
- Can management explain well "cash provided by or used in operations" – Both the amount and year-to-year change?
- Are gifts for endowment and capital properly excluded from operations?
- How are bond trustee funds handled?



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The Ford Foundation
Statement of Cash Flows (000's)
For Years Ended September 30, 2009 & 2008

	2009	2008
Cash Flows From Operating Activities:		
Change in unrestricted net assets	\$ (775,105)	(2,571,612)
Adjustments to reconcile change in unrestricted net assets to net cash used by operating activities:		
Realized depreciation (appreciation) on investments, net	553,092	(480,529)
Unrealized (appreciation) depreciation on investments, net	(116,569)	2,740,016
Depreciation	5,817	5,749
Pension-related and post-retirement changes other than net periodic pension costs	22,476	(3,890)
Provision for possible losses on program-related investments	5,337	1,788
Deferred provision (benefit) for federal excise taxes	1,194	(53,563)
Decrease (increase) in current federal excise tax receivable	3,800	(1,265)
Increase in other receivables and assets	(6,145)	(2,210)
Loans disbursed for program-related investments	(31,922)	(23,348)
Repayments of program-related investments	7,490	14,078
Grant Approvals	457,050	539,632
Grant Payments	(474,095)	(526,464)
(Decrease) increase in payables and other liabilities	(37,376)	4,927
Net Cash used by Operations	(384,956)	(356,821)



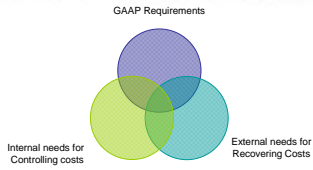
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March of Dimes Foundation
Statement of Cash Flows (000's)
For Years Ended December 31, 2009 & 2008

	2009	2008
Cash Flows From Operating Activities:		
Increase (decrease) in net assets	\$ 35,260	\$ (69,559)
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	2,217	2,121
Net (appreciation) depreciation in fair value of investments	(15,215)	32,082
Net (Increase) decrease in fair value of assets held in trust by others	(479)	1,871
Decrease (increase) in contributions and other receivables	1,475	(649)
Increase in assets held in trust by others attributable to contributions		(200)
Increase in inventory and other assets	(104)	(7)
(Decrease) increase in accounts payable and accrued expenses	(4,828)	507
Decrease in grants and awards payable	(11,322)	(1,365)
Decrease in refundable advances and deferred revenue	(1,030)	(727)
(Decrease) increase in accrued postretirement and pension benefit costs	(13,981)	40,944
Net Cash (used in) provided by operating activities	(7,997)	5,018
Cash flows from investing activities:		
Purchase of fixed assets	(5,621)	(3,822)
Purchase of investments	(56,591)	(75,269)
Proceeds from sale of investments	73,939	72,652
Net cash provided by (used in) investing activities	11,727	(6,439)



Cost Analysis



GAAP Requirements

- Broad Classifications
 - Natural classification – Type of expense
 - Functional classification – Purpose for which the expense is incurred
 - Program service expenses
 - Supporting service expenses

GAAP Requirements

- FAS ASC 958-720-45-15 (FAS 117)
 - All nonprofit entities must report their expenses by functional classification
 - Voluntary health and welfare entities must report their expenses by functional classification AND natural Classification
 - Other nonprofit organizations are encouraged to report expenses by natural classification but are not required to do so.

Internal Management

- Controlling expenses
 - Always interested in natural classification
 - Sometimes interested in functional classification
- Obtaining funding for program activities
 - Interested in expenses that may be charged to the funding source
- Controlling and obtaining funding
 - Confusion about what is a "program" activity

External Users of Financial Statements

- Contributors
- Funding Sources
 - Public – Governmental agencies
 - Private – Foundations
- Governing board
- Regulatory groups
- Watchdog groups

External Users of Financial Statements

- Relationship of program expenses and supporting expenses
 - Contributors
 - Private funding sources
 - Governing board
 - Regulatory groups

External Users of Financial Statements

- Watchdog Groups
 - Rating nonprofit organizations (Charity Navigator)
 - Who knows what else?

External Users of Financial Statements

- Public funding sources
 - Fee for service arrangement
 - Units of service provided
 - Cost of each unit of service
 - Cost-reimbursement arrangement
 - Cost chargeable to the contract
 - Confusion: Is a contract a program?

Cost Analysis

- Bringing GAAP, internal and external needs together
 - It's Possible!
 - Don't have to sacrifice one for the sake of the other!
 - Requires thorough understanding of:
 - The organization's structure, mission, and activities
 - The behavior of items of costs (natural classification)
 - The needs of funding sources (not assumptions)
 - Cost assignment and allocation based on the true benefit from the item of cost (not who can, who should, or who can afford it)

Important Terms

- Direct Cost
- Indirect Cost
- Supporting Service Costs
- Overhead Costs
- General Administration Costs
- Management and General Costs
- Program Cost

Important Terms:

Direct Costs

- Direct Costs may include
 - Natural classification – Salary of a social worker is direct cost of providing a program activity
- Not necessarily the same as “direct cost” definition of OMB Cost Principle Circulars

Direct Costs

<u>GAAP</u>		<u>OMB Cost Principle Circulars</u>	
Direct M&G	80,000	Direct M&G	80,000
Direct Fundraising	140,000	Direct Fundraising	140,000
Direct Programs	780,000	Direct Programs	780,000
Shared Costs	500,000	Shared Costs	500,000
Total Expenses	1,500,000	Total Expenses	1,500,000
Direct Cost:		Direct Cost:	
All But Shared	1,000,000	Direct Fundraising	140,000
		Direct Programs	780,000
		Total Direct Cost	920,000

Important Terms:

Indirect Costs

- Indirect (shared) costs may include
 - Natural classification – Rent of a facility that is shared by several program and supporting activities
- Not necessarily the same as “indirect cost” definition of OMB Cost Principle Circulars (Federal Government Rules – Not accounting)

Direct Costs

<u>GAAP</u>		<u>OMB Cost Principle Circulars</u>	
Direct G&A	80,000	Direct G&A	80,000
Direct Fundraising	140,000	Direct Fundraising	140,000
Direct Programs	780,000	Direct Programs	780,000
Shared Costs	<u>500,000</u>	Shared Costs	<u>500,000</u>
Total Costs	<u>1,500,000</u>	Total Expenses	1,500,000
Indirect Cost:		Indirect Cost:	
Shared Costs	<u>500,000</u>	Direct G&A	80,000
Total indirect:	<u>500,000</u>	Shared Costs	<u>500,000</u>
		Total Indirect Costs	<u>580,000</u>

Important Terms:

Supporting Service Costs

- May only include functional classification
- All non-profit costs of a nonprofit organization
 - Management and General (M&G); and
 - Fundraising; and
 - Membership development.
- Represents efficiency of the organization

Overhead Costs

- Same as supporting services costs
 - M&G; and
 - Fundraising; and
 - Membership Development
- Sometimes is referred to as "Indirect" – Big Confusion!
- Overhead ratio
 - Internal Rate
 - External Rate

Overhead Costs

<u>Internal Rate</u>		<u>External Rate</u>	
Supporting Service Costs	1,000,000	Supporting Service Costs	1,000,000
Program Service Costs	9,000,000	Program Service Costs	9,000,000
Internal Rate	1,000,000 / 9,000,000	Total Costs	\$ 10,000,000
	11%		
For every \$1 of program expense, NPO spends an additional \$.11 to support		External Rate	1,000,000 / 10,000,000
Full Cost of a program \$ is \$1.11			10%
		For every \$1 of contribution/income \$.90 is spent on program activities and \$.10 on supporting activities (overhead)	

General Administrative Costs

- Cost of the following activities:
 - Oversight
 - Business management
 - General recordkeeping, budgeting and financing
 - Soliciting funds other than contributions
 - Disseminating general information, announcements, annual reports, etc.
- Each activity may have direct or indirect item of cost (natural classification)

Important Terms:

Management and General Costs

- Same as “General Administrative” costs
- Not necessarily the same as “administrative” costs on various governmental grants and contracts
 - Example – Three different definitions of “administrative costs” by HUD programs – CDBG, HOME, HOPWA
- Not necessarily the same as “administrative” costs on various foundation grants.

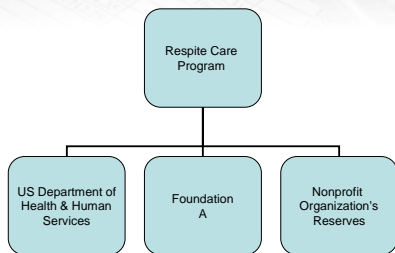
Important Terms:

Program Costs

- What is a “program” activity?
 - What each nonprofit is marketing/selling – Objectives to reach its mission
 - A core activity of a nonprofit organization regardless of who provides its funding
 - Respite care services
 - Family preservation services
 - Child Care provider training
- Not necessarily a funding source
 - A program activity may have several funding sources

Important Terms:

Program vs. Funding source



Full Recovery of Costs

- An appropriate chart of accounts to track income and expenses
- Define activities of the organization (both supporting and core program activities)
- Define projects within each activity
- Use an accounting software that can accommodate the appropriate tracking of income and expenses

Full Recovery of Costs

- Majority of the cost is personnel related
 - It should be the focus of allocation
 - Can an employee distinctly related their work to the identified project/activity?
 - Yes – Congratulations! You have successfully defined the activity/project
 - No – Try Again!
 - Capture employee efforts through an appropriate effort reporting system

Full Recovery of Costs

- Design and implement a cost assignment/ allocation plan
 - Direct Costs should be assigned to activities/projects
 - Shared costs should be allocated to activities/projects they benefit:
 - Individually when they are recorded on GL
 - Pooled in homogeneous pools and allocated at month-end in total

Full Recovery of Costs

- Understand the components of project/activity costs
- The cost of an activity / project includes:
 - Direct natural classification of costs
 - Indirect natural classification of costs (a reasonable portion of the shared or common costs)
 - Overhead/supporting services costs (a reasonable portion of such costs) – How much does the NPO spend to support each \$1 of program expense

Full Recovery of Costs

- Capture the full cost of a project in the accounting system
- Accounting system is not only the general ledger
- It includes:
 - Sub-ledgers
 - Spreadsheets
 - Data bases
 - Accounting Files, etc.

Full Recovery of Costs

- Private funding sources (Foundations)
- Form of a solicitation
 - Present a program activity or a distinct project
 - Present the full cost of the activity/project
 - Present how their funds are being leveraged

Full Recovery of Costs

- Direct funding from Federal Agencies
 - Negotiate and obtain an indirect cost rate
 - If no cognizant agency
 - Document your cost allocation plan
 - Document your indirect cost rate calculation
 - Have the Indirect cost rate calculation audited annually
 - Understand the limitations of the award
 - DO NOT CHANGE your accounting system to fit the requirements of the award – enhance it

Full Recovery of Costs

- State and Local Government Funds
 - Federal indirect
 - Non-federal
- Rules may be stricter than those of Federal Agencies
- Program staff dealing with financial issues
- Be smart, negotiate and get the best deal

Other Topics

Advanced NFP Accounting and Financial Reporting Issues

Financial Statement Choices

- Names of statements
 - Statement of Financial Position/ Balance Sheet
 - Classified or not
 - Liquidity sequencing
 - Disaggregation within net assets
 - Statement of Activities
 - Columnar or "Pancake"
 - Operating/nonoperating distinction
 - Expenses by natural classification
 - Statement of Cash Flows
 - Direct or Indirect
 - Note references on statement face
 - Focus on external or internal audience



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